DEL RIO RESOURCES LTD.

ANNUAL REPORT 1985

DEL RIO RESOURCES LTD.

ANNUAL MEETING

DATE: Wednesday, December 18th, 1985

PLACE: The Cardium Room
Calgary Petroleum Club
319 - 5th Avenue S.W.
Calgary, Alberta

TIME: 10:00 a.m.

Report to the Shareholders

The year which ended June 30, 1985, can best be described as remarkable and at times, bizarre. Five days into the new fiscal period the majority control of your Company was acquired by Tri-Line Freight Systems. Then, abruptly after the first quarter, Tri-Line experienced a change of heart and the control block, which had grown to 58% of the issued outstanding shares, was up for sale once again. The present management and directors who have a very large stake in the success of Del Rio have no such plans to dispose of their interests in the Company.

The philosophy of your new major shareholders and management is to increase the Company's share of oil and gas reserves in Canada's western provinces by

1. acquisition of producing oil and gas property,
2. exploration and development of new reserves.

I am happy to report on behalf of the Board of Directors that in spite of disruption and a number of disappointments the Company successfully increased its revenues and reduced the retained deficit. The net income for the year stood at $46,596 versus a loss of $101,886 on a 146.5% increase in revenues. While expenditures in the acquisition of and exploration for oil and gas properties totalling $103,058 on the Statement of Changes in Financial position appear to be off from the $248,606 spent in 1984, this year's figures are understated by the $36,775 expended under the Flow-Through Share Agreement and are further distorted by the active autumn and winter drilling program that was in the planning stages but not implemented before year-end. Working capital increased 54.8% during the year to $246,235. Including the balance of funds available from the Flow-Through Share Agreement this figure actually stood at $509,460 at year-end.

At the Annual Meeting, December 18, 1985, Shareholders will be asked to pass a Special Resolution enabling the Company to reduce its stated capital by $987,000. As you are aware, the Company owns a Gross Overriding Royalty Interest in approximately 19,880 acres of coal property near Drumheller, Alberta. A report dated May 26, 1983, from Neilsen Petroleum Associates Ltd. assigned a value of $988,000 (discounted at 15%) to the Company's interest. This property was in fact the foundation for the formation of Del Rio (the Financial Post classified Del Rio as a mining company). While present management does not question Neilsen's reserve calculations, it does have serious doubts about the probability of any revenue being generated in the forseeable future. To the best of the Company's knowledge, TransAlta Utilities Corporation, the operator, has no current plans to commence development of this property. The Company's cost of this property for income tax purposes is $3.00 in total. Hence there will be no tax benefit derived as a result of the write-down. However, as the properties were acquired in exchange for shares, the write-down is more appropriately charged to share capital rather than to the deficit. Anticipating successful adoption of the Resolution, we have presented the Balance Sheet after giving effect to the reduction of capital.

The Company participated in a total of five wells, excluding the Black Rock '83 Program. The D-3 reef test at Nevis and the Nisku test at Wood River drilled in the first quarter were dry and abandoned. Likewise the two wells at Sylvan Lake reported on in the third quarter were dry and abandoned. The fifth well, a 2500' Lloydminster test at LSD 7-2-41-3 W4M which spudded just prior to year-end came in producing at a rate of 136 barrels per day. However, within days the well was producing up to 90% water. The well has been shut-in for the winter and a decision with respect to producing or abandoning will be made in the spring. The decision is dependent upon the economics and availability of a treatment facility and a disposal well.

In early June a decision was made to suspend negotiations with the major shareholders of Black Gold Oil & Gas Ltd. to acquire control of that Company.

Subsequent to June 30, Del Rio announced it had entered into a Share Exchange and Sale Agreement to acquire working interests in about 100,000 acres of exploratory and development land in the Peace River Area of Alberta. Again, the Company was disappointed to learn upon closer examination that the economics of the acquisition made the deal untenable.

It remains management's ambition to complete an acquisition that will provide both additional property and expertise to the Company. We are confident Del Rio has both the potential from existing programs and the staying power to build a successful enterprise in the industry.

Respectfully submitted on behalf of the Board of Directors.

Kenneth C. Fowler, President

COMPANY PROPERTIES

Oil and Gas

Tatagwa

The Tatagwa field is located in southeastern Saskatchewan along the northeastern flank of the Williston Basin west of the well known Weyburn field. Oil production is from the Mississipian-Midale beds. Offsetting wells have cumulative oil production ranging from 4,000 barrels to over 100,000 barrels in less than two years. A number of highly productive wells average 95-100 barrels of oil per day with the most productive well over 200 barrels per day.

Drilling depth to the Midale formation is approximately 5,000 feet with the cost to drill, complete and equip a well for production close to $260,000. Del Rio has earned a 20% interest in the south half of section 28-5-15 W2M by participating in a well at LSD 7-28. Unfortunately the earning well was dry and abandoned. The Company is awaiting the results of some additional drilling in the area to gain better well control and knowledge of the geology.

Sunchild

Del Rio participated to the extent of an undivided 12.5% interest in the deepening of the well Dome et al Sunchild 11-23-43-11 W5M, from 2700 m to 3050 m. Del Rio earned a 12.5% interest BPO and a 6.25% interest APO in the Elkton and Shunda Formations. The well adjoins the Sunchild Unit, which produces gas and condensate.

Production casing has been set on the basis of favourable drillstem test results, and we are presently perforating and testing both Formations.

We are hopeful of establishing significant reserves of natural gas and condensate in this well at a most reasonable cost to the Company. Upon completion of the production testing, we are hopeful of producing the well through the Unit facilities.

Second Quarter Drilling Program

The Company has committed to drill a minimum of three and possibly five prospects prior to the calendar year-end. In each case, the Company's interest is 6% BPO — 3% APO.

Fenn 14-14-36-20 W4M

The Fenn prospect is located in central Alberta on a north-south trending reef structure. Just prior to production of this report the well was drilled dry and abandoned.

Colgate 9-14-5-15 W2M

The Colgate field is located in southeast Saskatchewan and is a relatively new field, having been discovered in 1983. The prospect well is located on the south end of the existing field and will be an oil test to the Midale formation, of Mississippian time. There are currently five producing wells in the pool, collectively having produced approximately 450,000 barrels of oil from the Midale formation over the last 1.5-2 years. Initial production on three of the wells has exceeded 200 barrels per day.

Fenn West 5-32-36-20 W4M

This prospect is located three miles to the north west of the Fenn prospect described above, and is on a north-south trending reef structure running parallel and to the west of the Fenn-Big Valley reef. The proposed well will be an oil test to the Nisku formation. An Offsetting well ½-mile to the north has recovered 136,000 barrels of oil from the Nisku, while a well 1.5 miles to the south has recovered 542,000 barrels of oil from the Nisku. The Nisku wells in this area are prolific and are capable of production in the 200-400 barrels per day range in their early life.

Fenn West 3-32-36-20 W4M

This prospect is a development location offsetting the 5-32 well. Drilling this location will be dependent upon the results of drilling the 5-32 well.

Fenn West 7-32-36-20 W4M

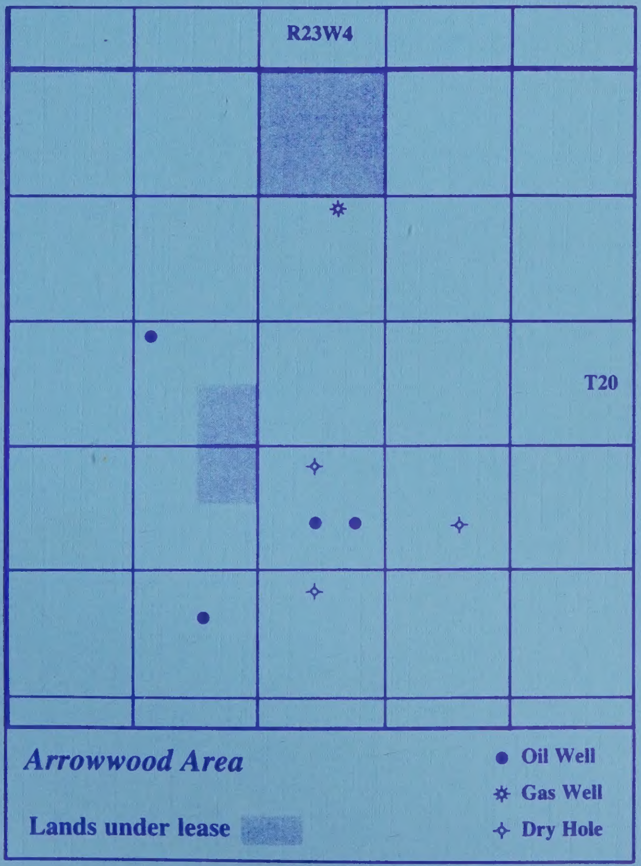
This prospect is a development location offsetting the 5-32 well. Drilling this location will be dependent upon the results of drilling the 5-32 well.

Arrowwood Area

Traditionally respected for its established gas reserves, Arrowwood is currently attracting considerable interest for its potential oil reserves as well. In addition to our 25% interest in the northwest quarter of section 17 and the southeast quarter of section 20 in township 20 range 23 W4M, we have participated with our partners in acquiring a further 25% working interest in the whole of section 33. We are presently evaluating a recently completed seismic survey to compliment our sub-surface mapping. Several possible drilling sites are expected to be revealed by these programs.

Precious Metals

The Company is currently evaluating the results of Drilling carried out at the Germansen Delta Joint Venture leases (Del Rio 25%) in 1985. A discovery of a 9 foot thick zone in a pre-glacial or tertiary river channel which carries placer gold values of up to $13.56 per yard has increased our enthusiasm towards the prospect. The channel appears to be the continuation, to the northeast, of the pre-glacial channel currently being mined by underground methods on the adjoining group of Placer leases. Cordilleran Resource Management Ltd. has recommended a program of further testing that could ultimately put the property into production in 1986. Partners are assessing the program with a decision required by early spring.



DEL RIO RESOURCES LTD.

BALANCE SHEET

ASSETS	June 30 1985	June 30 1984
Current assets:		
Cash	$ 8,735	$ 1,182
Term deposits	—	210,711
Accounts receivable and accrued	48,004	22,684
Recoverable advances (Note 6)	187,750	—
Recoverable deposit	25,000	—
	269,489	234,577
Investments, at cost:		
Limited Partnership (Note 2)	83,233	102,680
Securities (market value $26,563)	25,000	25,000
	108,233	127,680
Resource properties (Notes 1 and 3):		
Petroleum and natural gas properties	102,653	127,544
Coal and mineral properties	18,495	992,712
Well equipment	23,194	28,630
Furniture and fixtures	2,108	—
	146,450	1,148,886
Less: Accumulated depreciation and depletion	9,945	4,224
	136,505	1,144,662
	$ 514,227	$1,506,919

LIABILITIES AND SHAREHOLDERS' EQUITY

	1985	1984
Current liabilities:		
Accounts payable	$ 10,383	$ 50,542
Note payable (Note 2)	—	25,000
Flow-through share deposits (Note 4)	12,871	—
	23,254	75,542
Shareholders' equity:		
Share capital (Notes 3 and 4)—		
Authorized—		
An unlimited number of common, first preferred non-voting and second preferred non-voting shares		
Issued—		
1,725,258 shares	546,263	1,533,263
Deficit	(55,290)	(101,886)
	490,973	1,431,377
	$ 514,227	$1,506,919

APPROVED BY THE BOARD:

Director

Jerry W. Kelbon Director

STATEMENT OF OPERATIONS AND DEFICIT

		Year ended June 30	
		1985	1984 (Restated) (Note 1)
Revenue:			
Production revenue, net of royalties		$ 40,101	$ 11,711
Interest income		24,041	16,115
Share of Limited Partnership income (Note 2)		11,053	2,680
		75,195	30,506
Expenses:			
Depreciation and depletion		7,199	4,224
General and administrative		87,862	8,395
Production expenses		10,121	3,423
		105,182	16,042
Income (loss) before the following		(29,987)	14,464
Exploration expenses (Note 1)		(84,750)	(116,350)
Gain on sale of oil property		79,633	—
Gain on sale of securities		81,700	—
		76,583	(116,350)
Net income (loss) for the year		46,596	(101,886)
Deficit at beginning of year		(101,886)	—
Deficit at end of year		$ (55,290)	$ (101,886)

AUDITORS' REPORT

To the Shareholders of
Del Rio Resources Ltd.

We have examined the balance sheet of Del Rio Resources Ltd. as at June 30, 1985 and the statements of operations and deficit and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Company as at June 30, 1985 and the results of its operations and the changes in its financial position for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Antony Chittick Bleackley & Hanson

ANTONY CHITTICK BLEACKLEY & HANSON
Chartered Accountants

November 15, 1985
Calgary, Alberta

DEL RIO RESOURCES LTD.

STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year ended June 30 1985	1984 (Restated) (Note 1)
Financial resources were provided by:		
Operations—		
Net income (loss) for the year	**$ 46,596**	$ (101,886)
Add (deduct): Charges (credits) not involving working capital—		
Depreciation and depletion	**7,199**	4,224
Exploration expenses	**84,750**	116,350
Share of Limited Partnership income	**(11,053)**	(2,680)
Gain on sale of oil property	**(79,633)**	—
Gain on sale of securities	**(81,700)**	—
	(33,841)	16,008
Proceeds on sale of securities (net)	**81,700**	—
Proceeds on sale of oil property	**118,440**	—
Funds received from Limited Partnership (Note 2)	**5,500**	—
Issue of share capital	**—**	495,263
Cancellation of Limited Partnership note payable (Note 2)	**25,000**	—
	196,799	511,271
Financial resources were used for:		
Acquisition of oil and gas properties	**59,379**	—
Exploration and development expenditures	**43,697**	248,606
Well equipment additions	**4,415**	28,630
Acquisitions of furniture and fixtures	**2,108**	—
Investment in Limited Partnership	**—**	100,000
Acquisition of marketable securities	**—**	25,000
	109,599	402,236
Increase in working capital for the year	**87,200**	109,035
Working capital at beginning of year	**159,035**	50,000
Working capital at end of year	**$ 246,235**	$ 159,035

NOTES TO FINANCIAL STATEMENTS
JUNE 30, 1985

1. Significant accounting policies:

   (a) Petroleum and natural gas properties—

   Except for costs incurred under the flow-through share agreement (Note 4) the costs of petroleum and natural gas properties are initially capitalized. The costs of properties abandoned are charged against income when the properties are surrendered. Depletion of producing properties is provided for by the unit-of-production method based on estimated recoverable reserves of oil and gas. Exploration expenditures, including geological and geophysical expenses, and intangible drilling expenditures applicable to dry holes are charged to income as incurred. The well equipment is depreciated using the declining balance method at the rate of 30%.

   (b) Restatement—

   The 1984 statements of operations and deficit and changes in financial position have been restated so as to be comparative with the current year's presentation format.

2. Investment in Limited Partnership:

   During 1983 the Company acquired four units in the Blackrock Exploration Program — 1983 for a total cost of $100,000. The units were acquired on the basis of $50,000 in cash and two promissory notes of $25,000 due in November 1983 and 1984. The 1983 note was paid but the Partnership has advised that the 1984 note would not be called. Accordingly the note has been written off and the Partnership investment reduced accordingly.

   The Company is recording its investment in the Partnership on an equity basis — whereby the cost of its investment is increased by its share of income and reduced by funds received from the Partnership. The Company's share of income for the partnership year ended December 31, 1984 was $11,053 while funds received from the Partnership to June 30, 1985 amounted to $5,500.

3. Coal properties:

   The Company owns various percentage gross overriding royalty interests in coal properties near Drumheller, Alberta. These interests were acquired in April of 1983 at the appraised value of $988,000 in exchange for the issue of 658,666 shares of the Company at $1.50 per share. The acquisition was made in accordance with the provisions of Sec. 85 of the Income Tax Act and the agreed amount for income tax purposes was $3.

   The current management of the Company is concerned that present market conditions for coal do not support the previously appraised value and accordingly have written the coal properties down to a nominal value. As the properties were acquired in exchange for shares the write-down has been charged to share capital rather than being charged to deficit.

4. Share capital:

(a) Authorized share capital—

By special resolution of the shareholders the Company expanded its authorized share capital to include an unlimited number of First Preferred non-voting and an unlimited number of Second Preferred non-voting shares.

(b) Flow-through share agreement—

During the current year the Company entered into an agreement whereby it is to receive $300,000 which it will expend on Canadian Exploration and Development expenses by December 31, 1985. In exchange the Company will issue common shares on the basis of one common share for each $0.80 expended. In accordance with the provisions of the Income Tax Act the expenditures made will be allocated to and deductible by the investor.

As at June 30, 1985 the Company had expended $36,775 of these funds and the investor had therefore earned 45,969 shares although the shares had not been physically issued.

(c) Stock options—

As at June 30, 1985 the Company had granted stock options to officers and directors of the Company enabling them to acquire 170,000 shares at 30¢ per share. The options have no expiry date.

5. Income taxes:

At June 30, 1985 the Company had an unutilized loss for tax purposes of $139,964. This loss is available to be applied against taxable incomes of future years except that, if not so applied, the loss will expire June 30, 1991. The loss for tax purposes arises mainly from share issue costs which have been expensed for income tax purposes while being charged to share capital for accounting purposes.

In addition, the Company has recorded investment tax credits of $2,975 which can be used to reduce future Federal income taxes. If not so applied these credits will expire as follows:

June 30, 1989	$ 148
June 30, 1991	$2,005
June 30, 1992	$ 822

6. Related party transaction:

During the year the Company deposited certain funds with 313877 Alberta Inc., a company which owns 1,010,000 (58.5%) of the issued and outstanding shares. These demand deposits earn interest at 2% under the bank prime rate.

7. Subsequent events:

In July of 1985 the Company agreed to a private placement of shares whereby 165,000 shares were issued at 60¢ per share for a total of $99,000.

COMPANY INFORMATION

OFFICERS AND MANAGEMENT

Mr. Kenneth C. Fowler, President
Mr. Garry D. Kilbourn, Vice-President
Mr. Lawrence A. Wagar, Secretary

BOARD OF DIRECTORS

Mr. Kenneth C. Fowler
Mr. J. Gary Ibbotson
Mr. Garry D. Kilbourn
Mr. Lawrence A. Wagar

CORPORATE AND REGISTERED OFFICE

Suite 260, Iveagh House
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Calgary, Alberta T2P 3H6

LISTING

Alberta Stock Exchange: DRI

TRANSFER AGENT AND REGISTRAR

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AUDITORS

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